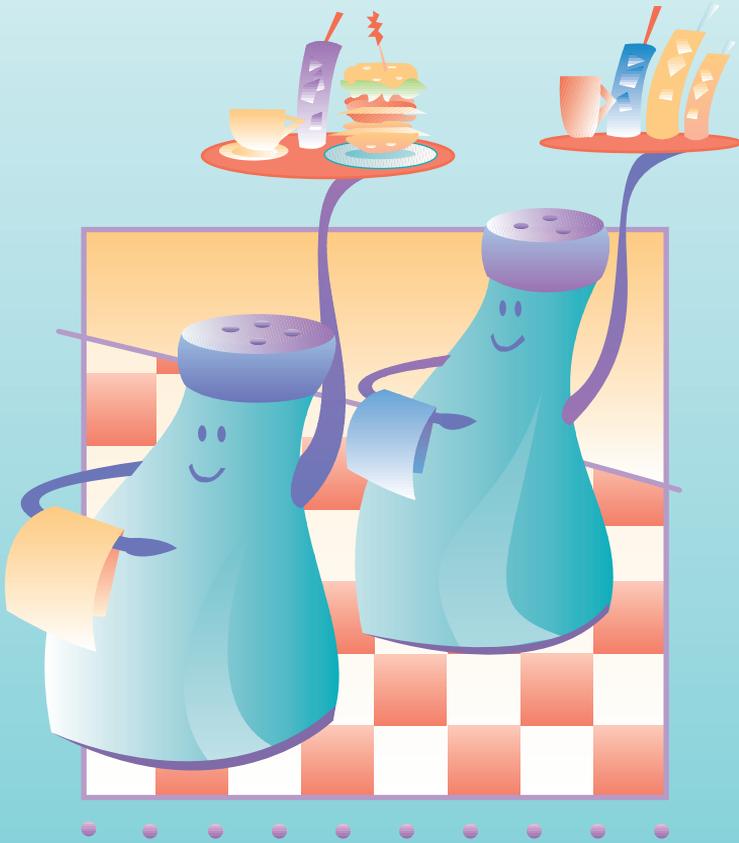


Tips on Tips



A Guide to Tip Income Reporting

**for Employees in the
Food and Beverage Industry**



**If you wait tables,
bus tables, park cars, bartend,
serve cocktails, deliver food, or
entertain, this guide is for you.**

As an employee of a food and beverage establishment, the tip income you receive – whether it's cash or included in a charge – is taxable income. As income, these tips are subject to federal income tax, social security and Medicare taxes, and may be subject to state income tax as well.

The Internal Revenue Service (IRS) has prepared this guide to aid the employee who may need answers to tip income reporting questions.

What tips do I have to report?

Do I have to report *all* my tips to my boss?

If you received \$20.00 or more in tips in any one month, you should report *all* your tips to your employer so that federal income tax, social security and Medicare taxes, and maybe state income tax can be withheld.



Do I have to report *all* my tips on my tax return?

Yes. All tips are income and should be reported on your tax return.



I was told that I had to report only eight percent (8%) of my total sales as tips. Is this true?

No. You must report to your employer *all* (100%) of your tips except for the tips from any month that do not total at least \$20.00. The 8% allocation rule is a requirement placed on the employer.

Here's how the 8% rule works:

The employer has to determine if the employees have reported tips in the aggregate of at least 8% of the establishment's gross sales subject to tipping. To put it another way, the employer adds all the establishment's gross receipts (sales where tipping is involved). Then the employer figures 8% of that number. If all the employees' reported-tips total less than that 8% figure, the employer figures out the difference between what the employees reported and the 8% amount. The employer then allocates that difference among all tipped employees. If an

employee reported less than the allocated amount to the employer, that allocated amount will appear on the individual's Form W-2, *Wage and Tax Statement*, in the box titled *Allocated Tips*.



Sometimes I don't get tips directly from customers, but rather from another employee. Do I need to report those tips?

Yes. Employees who are indirectly-tipped by another employee are required to report "tip outs." (Employees sometimes disburse tips out of their earned tips to another employee.) Remember, all tips are taxable income.



Do I have to report tip-outs that I pay to indirectly-tipped employees?

If you are a directly-tipped employee, you should report to your employer only the amount of tips you retain. Maintain records of tip-outs with your other tip income (cash tips, charged tips, split tips, tip pool).



What records do I need to keep?

What type of records do I have to keep?

You must keep a running daily log of all your tip income. Publication 1244, *Employee's Daily Record of Tips and Report to Employer*, allows you to record your tip income for one year. The publication includes Form 4070, *Employee's Report of Tips to Employer*, and Form 4070A, *Employee's Daily Record of Tips*. This form has spacing for you to log your name, the employer's name and address, date tips were received, date of entry, tips received, tips paid out, and name of employee paid. For a copy of this free publication, call the IRS at 1-800-829-3676. Your daily log would be your only record acceptable to the IRS in the event of an IRS examination.



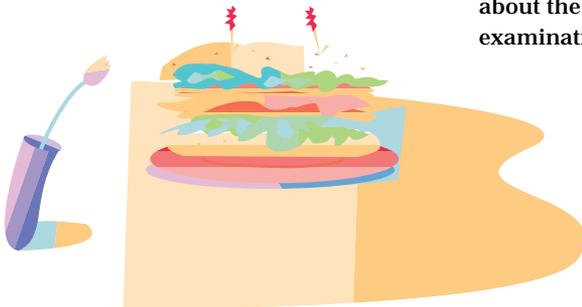
What can happen if I do not keep a record of my tips?

If it is determined in an examination that you underreported your tip income, the IRS will assess the taxes you owe based on the best available records of your employer. Tip income adds up. Underreporting could result in your owing substantial taxes, penalties, and interest.

If I report all my tips to my employer, do I still have to keep records?

Yes. You should keep a daily log of your tips so that in case of an examination, you can substantiate the actual amount of tips received. There are a number of reasons that you might need records:

- Your return could be randomly selected for a federal income tax examination. The examiner would look for underreporting of income. For example: Your Form 1040, *U.S. Individual Income Tax Return*, establishes that you have your own home, two cars, and three exemptions, and your Form W-2 shows that you earned only \$10,000 in income. This scenario may require an examination.
- A tip examiner could review your employer's books and records. The examination could reveal unreported tip income that you may later need to verify.
- An Internal Revenue Service Center may run a match of your income information from your Form 1040, *U.S. Individual Income Tax Return*, with the income information from your Form W-2. If these figures do not match, you could receive a notice about the discrepancy and a possible examination of your return.



How does this affect my income tax filing?

I forgot to report my tip income to my employer, but I remembered to record it on my federal income tax return. Will that present a problem?

If you do not report your tip income to your employer, but you do report the tip income on your federal income tax return, you may owe a 50% social security and Medicare tax penalty and be subject to a negligence penalty and possibly an estimated tax penalty. When you don't report your tips to your employer, it places your employer at risk of possible assessment of the employer's share of social security and Medicare taxes.



If I report all my tips but my taxes on the tips are greater than my pay from my employer, how do I pay the remaining taxes?

You can either pay the tax when you file your federal income tax return or you can reach into your tip money and give some to your employer to be applied to those underwithheld taxes. The employer will then record these taxes and you will get credit on your Form W-2. If you wait to pay when you file your return, you may be subject to an estimated tax penalty.

What can happen if I don't report my tips to the IRS?

If the IRS determines through an examination that you underreported your tips, you could be subject to additional federal income tax, social security and Medicare taxes, and maybe state income tax. Also, a penalty of 50% of the additional social security and Medicare taxes, and a negligence penalty of 20% of the additional income tax, plus interest may apply.



What's in it for me if I report all my tip income?

There are many good reasons why you want to report all your tip income:

- Increase in social security benefits (the more you pay, the better your benefits)
- Increase in unemployment compensation benefits
- Increase your employee pension, annuity, or 401(k) participation
- Improve credit standing for loans (home, car)
- Compliance with the tax law and avoidance of an examination and possibly increased taxes, penalties, and interest owed



What is this compliance program I've heard about?

My employer has entered into a compliance agreement with the IRS concerning tips. What is this?

The *Tip Rate Determination/Education Program* created in 1993 is a national program used in all states. The employer has the option to enter into one of two arrangements under this program: the *Tip Rate Determination Agreement (TRDA)* or the *Tip Reporting Alternative Commitment (TRAC)* (created in June 1995). You can ask your employer for more information about this program.



TRDA

What is my responsibility, as an employee, under the *Tip Rate Determination Agreement*?

You are required to file your federal tax returns. You must sign a *Tipped Employee Participation Agreement* proclaiming that you are participating in the program. The employer, as a participant in the *TRDA*, has agreed with the IRS to a tip rate for the employer's establishment. To stay a participating employee, you must report tips at or above the tip rate determined by the agreement. Further, as part of the *TRDA* arrangement, the employer is required to report your name, social security number, the hours worked or sales made, your job classification, and your reported tips to the IRS if you *do not* report tips at or above the determined tip rate.

TRAC

What is my responsibility, as an employee, under the *Tip Reporting Alternative Commitment*?

Directly-tipped employee:

- Your employer will furnish you a written statement (at least monthly) reflecting your charged tips.
- You are to verify or correct this statement.
- You are to indicate the amount of cash tips received.
- When reporting your cash tips, you should remember that there is a correlation between charged tips and cash tips.

(Your employer may be able to inform you of the establishment's charged sales to cash sales ratio. For example, if the establishment is 50% charge and 50% cash, and you received and reported \$100 in tips on charged receipts, it is reasonable to believe that you should be reporting close to \$100 in cash tips.)

- You may be asked to provide the name and amount of any tip-outs to indirectly-tipped employees.

Indirectly-tipped employee:

- You are required to report all your tips to your employer. If the establishment has the directly-tipped employee provide the name and amount of tips shared with you, the establishment could provide you with a statement of tips that you would need to verify or correct.

Is tip reporting unique to the food & beverage industry?

Does tip income reporting apply only to the food and beverage industry?

No. Anyone who receives tip income is required by law to report it to his or her employer. The *Tip Rate Determination/ Education Program (TRD/EP)* was first promoted in the gaming industry (casino industry) in Las Vegas, Nevada, and has spread to the food and beverage industry. Other industries that receive tips include beauty parlors, barber shops, taxi companies, and pizza delivery establishments.

Why should I report my tips to my employer?

When you report your tip income to your employer, the employer is required to withhold federal income tax, social security and Medicare taxes, and maybe state income tax. Tip reporting may increase your social security credits resulting in greater social security benefits when you retire.

Tip reporting may also increase other benefits to which you may become entitled, such as unemployment benefits or retirement benefits. Additionally, a greater income may improve financing approval for mortgage, car, and other loans.

Why has tip reporting become such an issue?

To report all tip income has always been the law. The IRS has put greater emphasis on reporting tip income over the past few years because a significant number of taxpayers are not reporting all tip earnings as income.

How can I get more information?

The IRS provides the following publications and forms relating to tip income reporting. To order, call the IRS at 1-800-829-3676. (TDD equipment access, dial 1-800-829-4059.)

Pub 505 – *Tax Withholding and Estimated Tax*

Pub 531 – *Reporting Tip Income*

Pub 1244 – *Employee's Daily Record of Tips and Report to Employer*. This publication includes **Form 4070**, *Employee's Report of Tips to Employer*, and **Form 4070A**, *Employee's Daily Record of Tips*.

Form 1040ES – *Estimated Tax for Individuals*

Form 4137 – *Social Security and Medicare Tax on Unreported Tip Income*





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